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September 15, 2008

AGENDA ITEM 10a

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. SUBJECT:** Review of Corporate Governance Focus List, Proxy, and Education & Influence Program
- II. PROGRAM:** Global Equity
- III. RECOMMENDATION:** Information Only
- IV. ANALYSIS:**

Executive Summary

This agenda item addresses Investment Committee (Committee) requests at its March 2008 meeting on the performance of the Corporate Governance Program. At the August 2008 Committee meeting, staff presented a performance review of the Corporate Governance Investment Program. Through this agenda item, staff has prepared a fiscal 2007-2008 performance review of the Corporate Governance Focus List Program, Proxy Voting Program, and Education & Influence Program, which create the framework for achieving the following objectives:

- Implement CalPERS' Focus List Program to generate positive economic return through constructive engagement of portfolio companies in order to improve corporate governance structures.
- Encourage and support global reform to protect investor and shareowner interests through legislative, regulatory, exchange, and investor forums.
- Promote and encourage corporate governance reform at individual portfolio companies to improve domestic, international and emerging markets governance standards, and investment performance.
- Enhance and execute CalPERS' proxy voting responsibilities, corporate engagement, and governance initiatives consistent with the Investment Committee's Global Principles of Accountable Corporate Governance.

Focus List Program

CalPERS' Focus List Program is an economically driven strategy targeting underperforming companies in the Fund's largest equity portfolio – the CalPERS Domestic Index Fund. The CalPERS Focus List Program has evolved over time since its inception in 1987. A more formal annual public listing of Focus List companies began in 1992 when CalPERS publicly identified ten large corporations as poor performers. The objective of the Focus List process is to generate positive economic return to CalPERS as a shareowner by improving corporate governance structures through constructive engagement of portfolio companies.

CalPERS believes that fully accountable corporate governance structures produce the best returns to shareowners over the long-term. Studies indicate the CalPERS Focus List adds economic value to CalPERS in addition to providing a positive market impact by influencing publicly traded companies to adopt good governance principles. In a 2008 study, Wilshire Associates evaluated the "CalPERS Effect" of corporate governance activities and the performance of the stocks of companies targeted by CalPERS from the beginning of the Focus List Program in 1987 through the fall of 2006. Study results indicate that, for the five years prior to the "initiative date," the Focus List companies produced returns that averaged 82.2% below their respective benchmarks on a cumulative basis, which is equivalent to an excess return of -12.7% per year on an annualized basis. For the five years following the "initiative date," the average targeted company produced an excess return of 15.7% above its respective benchmark return on a cumulative basis, or approximately 3% per year on an annualized basis.

In an effort to enhance CalPERS' effectiveness, staff continually monitors the market and corporate governance environment to identify governance issues that warrant the greatest amount of shareowner attention. For example, this last year staff placed considerable emphasis on board leadership, succession planning, corporate takeover defenses, majority voting for director elections, and executive compensation practices. While the methodology has evolved over time, it has always been based on an annual cycle of quantitative and qualitative evaluation.

In the Fall of 2007, the Investment Committee approved sixteen 2008 Focus List Candidate companies. Staff made progress towards improving the overall alignment of interest between executive management, the board of directors, and shareowners with each of the companies engaged. In aggregate, the sixteen companies agreed to implement forty-four of CalPERS' requests covering sixteen different subjects based on CalPERS' Global Principles of Accountable Corporate Governance.

The following includes a few of this year's successes:

- Remove Classified Board Structure: Nine companies agreed to seek and support shareowner approval to declassify their boards at CalPERS' request.
- Implement Majority Vote for Directors: Nine companies agreed to CalPERS' request to adopt a majority vote provision.

- Remove Supermajority Voting Requirements: Nine companies agreed to CalPERS' request to remove supermajority voting requirements.
- Improve Board Accountability: Six companies agreed to take action on board accountability issues such as separating the role of chair/CEO, nominating a lead independent director, and/or defining leadership roles by implementing a duty statement for the independent chair or independent lead director.
- Implement Clawback Policy: Seven companies agreed to adopt a clawback policy to recapture bonus and incentive payments in the event of officer fraud or misconduct.
- Seek Annual Ratification for the Auditor: Two companies agreed to CalPERS' request to seek annual shareowner ratification for the auditor.

In the Spring of 2008, the Investment Committee approved five companies for inclusion on the 2008 public Focus List. Table 1 lists CalPERS' 2008 Focus List.

Table 1: 2008 Focus List

Company Name	Ticker	Industry
Cheesecake Factory, Inc.	CAKE	Hotels Restaurants & Leisure
Hilb Rogal & Hobbs Co.	HRH	Insurance
Invacare Corp.	IVC	Health Care Equipment & Supplies
La-Z-Boy, Inc.	LZB	Household Durables
Standard Pacific Corp.	SPF	Household Durables

Staff continues to engage each 2008 Focus List Company to ensure each governance concern is addressed. Progress with each of the 2008 companies is summarized as follows:

Cheesecake Factory, Inc.: At CalPERS' request, the Company agreed to declassify the board beginning in 2009, implement a majority vote policy in director elections, and adopt and disclose a compensation claw-back policy.

Hilb Rogal & Hobbs Co.: CalPERS ran a successful shareowner proposal to declassify the board at the May 2008 Annual Meeting with the proposal receiving 77% of votes cast. In June 2008, it was announced that HRH would be acquired by Willis Holdings Group.

Invacare Corp.: At CalPERS' request, the Company successfully removed the supermajority voting requirements at the May 2008 Annual Meeting, nominated a lead independent director, adopted and disclosed a compensation claw-back policy, and disclosed equity dilution levels.

La-Z-Boy, Inc.: CalPERS ran a successful shareowner proposal to declassify the board at the August 2008 Annual Meeting with the proposal receiving 64% of votes cast. At CalPERS' request, the Company successfully removed the supermajority voting requirements at the August 2008 Annual Meeting, and implemented a majority vote policy in director elections.

Standard Pacific Corp. (SPF): CalPERS ran a successful shareowner proposal to declassify the board at the May 2008 Annual Meeting with the proposal receiving 72% of votes cast. Following this vote, the Company removed the supermajority voting requirements and declassified the board.

Proxy Voting Program

CalPERS' Global Principles of Accountable Corporate Governance (Global Principles) allow staff to efficiently and effectively implement its Corporate Governance Program responsibilities. Staff executes all proxy voting instructions, portfolio company engagements, and corporate governance initiatives in a manner that is consistent with the Global Principles as described in CalPERS' Global Proxy Voting Policy. For example, for the fiscal year 2007/2008, staff voted 7,471 separate global proxies in compliance with CalPERS' Global Principles. Translated versions of CalPERS' Global Principles are available in Chinese, French, Japanese, German, and Spanish with translated versions currently accessible through CalPERS' Shareowner Forum (<http://www.calpers-governance.org>).

In March of 2008, CalPERS approved revisions to the Statement of Investment Policy for Global Proxy Voting, including policy template improvements and one technical amendment to define the Committee's corporate governance principles in a single document, entitled Global Principles of Accountable Corporate Governance, instead of the previous two document structure (Core Principles and Global Principles.) This revision improves the efficiency of working with the Committee's framework of principles by eliminating the need to refer to multiple documents.

In addition to the consolidation of CalPERS' Principles, over the last twelve months, the Investment Committee approved new Principles encompassing CEO/Director succession planning, audit integrity, executive compensation, board diversity, environmental disclosure, and the elimination of human rights violations in emerging markets. These new Principles support CalPERS' principles based approach to voting proxies, influencing the capital marketplace, engaging companies, and implementing Corporate Governance initiatives to maximize Total Fund returns.

2008 has been an exceptional year in demonstrating CalPERS' shareowner proposal accomplishments. Chart 1 shows the numbers of shareowner proposals filed by CalPERS by fiscal year. A number of these filed proposals were eventually withdrawn, primarily due to companies agreeing to adopt corporate governance practices as a result of CalPERS' engagement. However, not every proposal was withdrawn and a number of CalPERS proposals eventually made it to the corporate proxy to be voted on by shareowners. In those instances, targeted shareowner solicitation campaigns were initiated to advocate support for CalPERS' proposals. Chart 2 shows the growth in the number of CalPERS proposals on corporate proxies, requiring greater use of the Corporate Governance Resource Pool.

Chart 1: Number of CalPERS Shareowner Proposals Filed

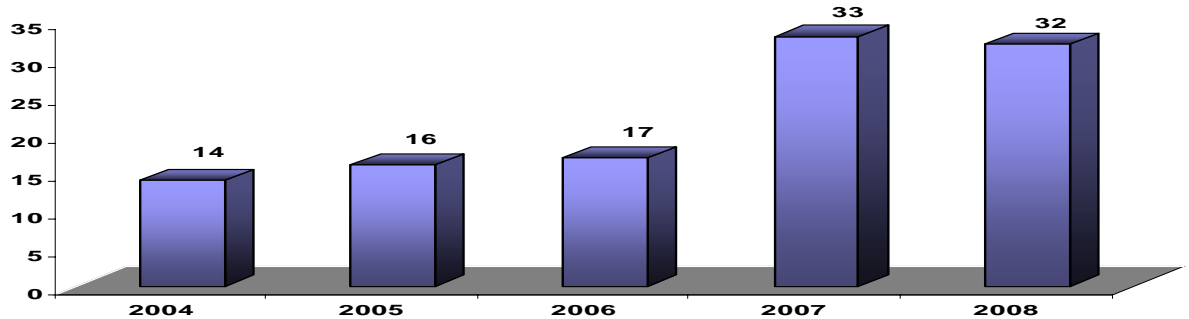
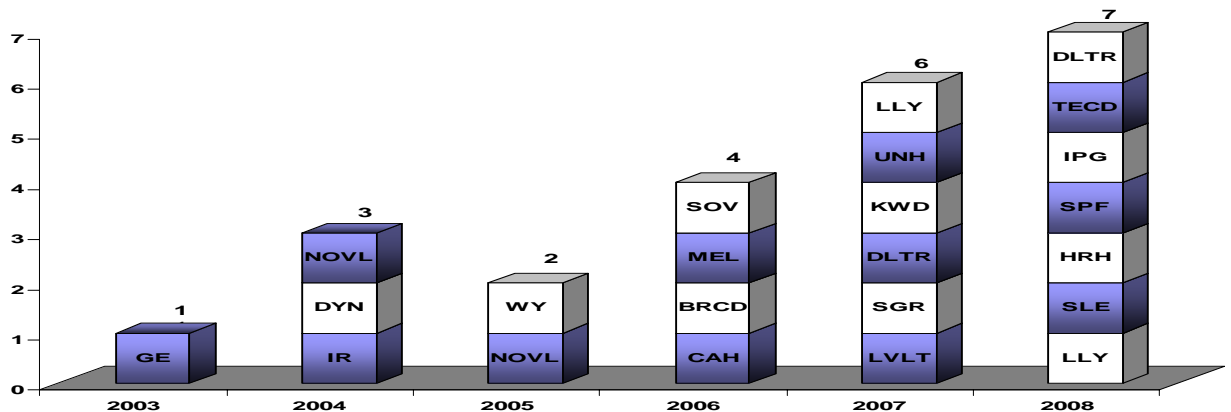


Chart 2: Number of CalPERS Proposals on Proxy



CalPERS' 2008 proposals have achieved significant results averaging investor vote support of 65% compared to 64% the previous year, highlighted most recently by achieving support from 82% of Dollar Tree shareowners for a board declassification proposal. The high average investor support levels for CalPERS proposals on corporate proxies demonstrates increased effectiveness in obtaining significant voting support through proxy solicitation campaigns. Table 2 details the company, shareowner proposal subject, and shareowner support results for CalPERS resolutions that were filed and subsequently voted on in 2008.

Table 2: CalPERS Proposal – Filed and Voted On in 2008

Company	Shareowner Proposal Subject	Shareowner Support
Sara Lee	Shareowner Ability to Amend Bylaws	79%
Eli Lilly	Shareowner Ability to Amend Bylaws	49%
Hilb Rogal & Hobbs	Board Declassification	79%
Standard Pacific	Board Declassification	72%
Interpublic Group	Executive Compensation Shareowner Advisory Vote	33%
Tech Data	Executive Compensation Shareowner Advisory Vote	61%
Dollar Tree	Board Declassification	82%

Education & Influence Program

In fiscal 2007-2008, CalPERS continued to implement Global Equities' long-term goal of enhancing the System's leadership position in corporate governance at the policy level for the purpose of protecting shareowner interests and investment assets. Staff devoted significant resources to educating and influencing shareowners, corporations, regulatory authorities, stock exchanges, and other institutional investors on issues that will improve investor economic protections, shareowner rights, ethical responsibility, accountability, and transparency.

Enhancing CalPERS' leadership position in corporate governance through its Education & Influence Program can be framed by staff's active participation in a membership on influential stakeholder entities, public written correspondence, and investor action to communicate CalPERS' corporate governance perspective as an investor. For example, Table 3 summarizes regulatory, oversight, and investor organizations where staff demonstrated corporate governance leadership on behalf of CalPERS in fiscal 2007-2008.

Table 3: CalPERS Leadership in Fiscal 07/08

Organization	Function	Staff Role	Objective
New York Stock Exchange (NYSE)	Pension Managers Advisory Committee	Committee Member	Conveying investor concerns to the NYSE
Financial Accounting Standards Board (FASB)	User Advisory Council	Council Member	Providing investors' perspective in accounting standard setting
Public Company Accounting Oversight Board (PCAOB)	Standing Advisory Group	Advisory Member	Providing investors' perspective on auditing standards
International Corporate Governance Network (ICGN)	Accounting & Auditing Practices Committee	Chair	Ensuring quality and integrity of global financial reporting
Council of Institutional Investors (CII)	Board of Directors	Chair	Protecting U.S. shareowner rights and investment assets
Ceres	Board of Directors	Board Member	Integrating sustainability into capital markets
United Nations Principles for Responsible Investment (UNPRI)	Board of Directors	Advisory Board and Working Group	Incorporating ESG issues into investment decision-making and ownership practices
Asian Corporate Governance Association (ACGA)	Institutional Investor Group	Member	Implementing effective corporate governance in Asia
Global Investor Governance Network (GIGN)	Institutional Investor Group	Coordinating Committee Member	Implementing corporate governance best practices through global investor support
Robert Toigo Foundation	Advisory Board	Board Member	Encouraging minority presence across all areas of finance
Executive Compensation Advisory Vote Working Group	Investor, Corporate, and Academic Working Group	Coordinating Committee Member	Executive compensation shareowner advisory vote at publicly traded companies

In addition to advocating policy reform measures through active participation on regulatory, oversight, and investor entities, CalPERS exhibited leadership through public written correspondence to regulators, corporations, and exchanges, addressing the improvement of corporate governance best practices. CalPERS submitted over 70 comment/response letters in fiscal 2007-2008. Table 4 provides a sample of recipients and topics.

Table 4: CalPERS Fiscal 07/08 Comment Letters

Recipient	Topic/Issue
SEC Chairman Cox	Investor Network on Climate Risk (INCR) meeting request to discuss climate risk disclosure in regulatory filings
PCAOB	Audit of internal control over financial reporting integrated with audit of financial statements, independence rule, and conforming amendments
US Senate Banking Committee	Support for advisory shareowner vote on executive compensation legislation
PCAOB	Communications with audit committees concerning independence
PCAOB	Tax services for persons in financial reporting oversight roles
SEC	CalPERS support for proxy access
SEC	U.S. issuers to prepare financial statements in accordance with international financial reporting standards
U.S. Senators Reid, Pelosi, McConnell, and Assemblyman Boehner	Investor Network on Climate Risk (INCR) letter calling on Congress to pass Energy Bill
PCAOB	Guidance for auditors of smaller public companies
European Commissioner McCreevy	Recommendations on specific measures in the area of statutory audits
SEC	Mechanisms to access disclosures relating to business activities in or with countries designated as state sponsor of terrorism
US Treasury Department Advisory Committee on the Auditing Profession	Sustainability of a strong and vibrant auditing profession
Australian Securities Exchange	Consultation on Non-Voting Ordinary Shares
Singapore Accounting and Corporate Regulatory Authority, Monetary Authority, Stock Exchange	Support of Asian Corporate Governance Association (ACGA) on the issue of multiple proxies for shareholder meetings
National Association of Insurance Commissioners	Investor Network on Climate Risk (INCR) support for the Climate Risk Disclosure Proposal
SEC Chairman Cox	Broker no-votes
US Senators Menendez, Dodd, and Reed	Questions for confirmation process of nominees to SEC
CII	CII proposed council statement on financial gatekeepers
Washington Mutual, Standard Pacific Corporation, and Citigroup Directors	Asset valuation and compensation tied to subprime mortgage meltdown
SEC Chairman Cox	Disclosure of compensation consultant independence
Tokyo Stock Exchange	Endorsement of Asian Corporate Governance Association (ACGA) White Paper on needed improvement of corporate governance practices in Japan

Finally, in addition to participating in an advisory or board member capacity and advocating policy reform measures through public written correspondence, staff identified and conveyed of CalPERS' position on corporate governance best practices at a number of important venues. Actions to support CalPERS' leadership in corporate governance over the last fiscal year include:

- Maintaining commitment to shareowner proxy access for the purpose of nominating director candidates as the number one corporate governance priority for CalPERS by filing a shareowner proposal at Kellwood, meeting with

members of Congress and congressional staff members on the issue, and ensuring proxy access is addressed with SEC Commissioner Nominees.

- Testifying to the Senate Subcommittee on Securities, Insurance, and Investment hearing on Climate Disclosure: Measuring Financial Risks and Opportunities.
- Advocating CalPERS' corporate governance position as an investor in emerging markets, including Brazil, South Africa, and Israel.
- Attending the National Association of Corporate Directors – Blue Ribbon Commission on Board and Shareholder Communications for the purpose of contributing to the creation of a report summarizing the issues and resolutions necessary for effective corporate board structures.
- Attending the International Monetary Fund's International Working Group of Sovereign Wealth Funds Roundtable meeting for the purpose of contributing thought leadership to the drafting of a set of voluntary best practices and principles for sovereign wealth funds.
- Advocating CalPERS' corporate governance priorities to a wide constituency of California trustees and their proxy voting staff at an Institutional Investor Forum in an effort to help shape the governance practices of some the smaller California pension plans.
- Advocating CalPERS' investor perspective on shareowner activism and corporate governance by attending and presenting to corporate lawyers and executives at the 2008 Minority Corporate Counsel Association's Continuing Legal Education (CLE) Expo.
- Advocating CalPERS' investor perspective on the future of corporate governance to health system trustees and executives for US hospitals and health organizations at the Leapfrog Conference: The Future of Hospital Governance.
- Engaging portfolio companies for the purpose of improving environmental disclosure of the risks and opportunities associated with climate change.
- Communicating CalPERS' corporate governance proxy voting actions, perspective, initiatives, and principles through its public Shareowner Forum Website (<http://www.calpers-governance.org>).

Conclusion

Going forward, staff will continue to implement the Investment Committee's objective to position CalPERS in a leadership role as an active shareowner with companies, fellow investors, and congressional and regulatory leaders, to protect the System's equity investments while striving to achieve sustainable long-term value creation. Staff will implement CalPERS' Focus List Program to generate positive economic return through constructive engagement of portfolio companies in

order to improve corporate governance structures. Staff will continue to encourage and support global reform to protect investor and shareowner interests through legislative, regulatory, exchange, and investor forums, as well as at individual portfolio companies. Finally, staff will continue to seek out opportunities to enhance and execute CalPERS' proxy voting responsibilities, corporate engagement, and governance initiatives, consistent with the Investment Committee's Global Principles of Accountable Corporate Governance.

V. STRATEGIC PLAN:

The item is consistent with the Strategic Plan: Goal I, Exercise global leadership to ensure the sustainability of CalPERS' pension and health benefit systems; and Goal IX, Achieve long-term, sustainable risk adjusted returns.

VI. RESULTS/COSTS:

The costs associated with this item are minimal as they are already absorbed by other ongoing CalPERS investment programs.

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